

VZCZCXRO2823
PP RUEHGI RUEHRN
DE RUEHNR #1002/01 0610802
ZNR UUUUU ZZH
P 020802Z MAR 07
FM AMEMBASSY NAIROBI
TO RUEHC/SECSTATE WASHDC 7911
INFO RUEHXR/RWANDA COLLECTIVE PRIORITY
RUEHFR/AMEMBASSY PARIS 2128
RUEHLO/AMEMBASSY LONDON 2172
RUEHBJ/AMEMBASSY BEIJING 0313
RUEHMD/AMEMBASSY MADRID 0116
RUEHSM/AMEMBASSY STOCKHOLM 0516
RUEHGH/AMCONSUL SHANGHAI 0016
RUEHGZ/AMCONSUL GUANGZHOU 0022
RUEHSH/AMCONSUL SHENYANG 0015
RUEHCN/AMCONSUL CHENGDU 0016
RUEHHK/AMCONSUL HONG KONG 0080
RUEATRS/DEPT OF TREASURY WASHDC
RUCPDOG/DEPT OF COMMERCE WASHDC

UNCLAS SECTION 01 OF 03 NAIROBI 001002

SIPDIS

SENSITIVE

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DEPT FOR AF/E AND AF/EPS

E.O. 12958: N/A

TAGS: [ECON](#) [ETRD](#) [EPET](#) [EINV](#) [ENRG](#) [KE](#) [CH](#)

SUBJECT: China in Kenya: No Appetite for Investment, But a Thirst For Oil

Refs: A. Nairobi 0266, B. Nairobi 0075, C. 06 Beijing 23548, D. 05

Nairobi 3600

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¶1. (SBU) Summary: Chinese companies appear to have little appetite for making significant investments in Kenya. One reason: Kenya's investment climate still leaves a lot to be desired. Another: Chinese companies probably figure it's easier to export goods efficiently made in China than it is to set up factories and produce locally. The one special exception is oil, a sector in which the state-owned Chinese offshore oil company was last year mysteriously given 28% of Kenya's total exploration acreage, without even a commitment to drill in five of the six blocks awarded. The deal was politically motivated at best (and probably worse), and illustrates that the Kenyan political leadership is willing to hurt itself in economic terms at the moment in order to advance its political relationship with Beijing. End summary.

Investment? What Investment?

¶2. (SBU) When he returned from the Forum for China-Africa Cooperation (FOCAC) in November 2006, Kenyan President Mwai Kibaki declared his visit "a milestone...in securing crucial commitments by the Chinese Government to support development projects in Kenya." Loan and grant agreements worth perhaps \$50 million were signed, aviation landing rights were granted, and a number of cooperative agreements in an array of technical fields were concluded. Kenya will also no doubt benefit significantly from the African regional initiatives announced by PRC authorities at the FOCAC, including a doubling of aid to the continent by 2009, and the establishment of two \$5 billion funds to spur trade and investment between China and Africa (ref C). Meanwhile, Chinese firms are gobbling up big-ticket infrastructure projects in Kenya, including a major road upgrade in Nairobi, the World Bank-funded renovation and expansion of the capital's international airport, and the expansion of the gas pipeline linking Mombasa and Nairobi.

13. (SBU) Missing from the FOCAC visit and thereafter, however, were any announcements about blockbuster private sector deals involving Chinese firms in Kenya. Indeed, in all of the hullabaloo over China's deepening economic and political ties to Kenya (refs B and D), few heed the missing link: increased flows of the kind of private sector-led foreign direct investment (FDI) that would sustainably boost economic development by generating jobs, income, tax revenues, and technology transfers.

Chinese Traders, Not Investors

14. (SBU) The Director of Research at the Kenya Investment Authority put it best when he told Econ/C and Econ Specialist in mid-January that "the Chinese are traders, not investors." The official had himself just returned from a month-long, PRC government-sponsored study tour of the China, and he was candidly less-than-impressed. Chinese rules make it difficult, he said, for Chinese firms to take foreign exchange out of China for investment in Africa. Most Chinese investment in Kenya is therefore small-scale, made by Chinese exporters. These firms are allowed to reinvest overseas any trading profits made there, but their investments tend to be small-scale in nature - local trading companies, restaurants, and the like. These are welcome, but don't have a major impact on growth, development, or job creation.

15. (SBU) The Chinese DCM in Nairobi acknowledged as much in a late January conversation with Econ/C. AUCMA, a Chinese owned television assembly plant in Kenya (see ref D) is making money and producing 500 TV sets a day for the regional market, he said. But he was otherwise unable to cite a significant example of Chinese investment in Kenya beyond the special case of oil (see below), about which he was mum. The Chinese government is trying to encourage greater private sector investment in Kenya and elsewhere, he said, but Chinese firms simply aren't very interested. He believes ref D's estimate of around \$100 million in PRC FDI in Kenya is about right,

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but acknowledged that there is no reliable statistical measure of FDI flows in Kenya.

But Black Gold is Different

16. (SBU) The pattern of Chinese indifference to investing in Kenya is broken in the case of oil and other extractive industries. As noted ref D, for example, China's Jianchuan Group is believed to have made a minority investment in a titanium mine project in Kenya's Kwale District which is owned by Tiomin, a Canadian firm. Details, however, have not been disclosed and the oft-delayed project has yet to begin operations.

17. (SBU) On the hydrocarbon front, neither oil nor gas have ever been discovered in Kenya. But geologists have long believed there may be significant quantities of one or both in Kenya, both on and offshore. The PRC, true to its reputation for scouring the globe for supplies of natural resources, is heavily involved in Kenya's upstream oil and gas sector. In April, 2006, Kenya awarded (apparently free-of-charge) six of its 11 available oil exploration blocks to the Chinese National Offshore Oil Company (CNOOC), a whopping 28% of all oil exploration acreage in the country. The deal followed the August 2005 state visit to Beijing by President Kibaki (ref D), and immediately preceded a reciprocal visit to Kenya by Chinese President Hu Jintao to Kenya later that same month.

18. (SBU) Terms of the CNOOC deal have not been disclosed, but two other international firms, Lundin of Sweden and Cepsa of Spain, protested that they had been unfairly shut out of the bidding for the blocks, despite having offered better terms than CNOOC. The Swedish Embassy later confirmed to Econ/C that Lundin and Cepsa had both offered to move immediately to drilling test wells, whereas CNOOC agreed to drill on only one of the six blocks for which it acquired rights. It is believed drilling must take place there within a year. On the other five blocks, CNOOC was granted "study

agreements" under which it need only undertake tabletop surveys. The Chinese, as one Nairobi-based oil executive recently said, are "just sitting on acreage."

¶9. (SBU) A good Embassy contact and member of the board of the National Oil Company of Kenya (NOCK) told Econ/C in early December 2006 that the CNOOC deal was either political or corrupt - or both. NOCK, which is state-owned but has no political clout, knew nothing about the deal until it was presented to the company as a fait accompli. It pushed back, but was overridden by the political leadership. Again, without disclosing terms, this contact said the deal was not a good one for Kenya because it put too much exploration acreage into the hands of a single foreign company and because the other international companies interested in the blocks would have been more aggressive in drilling test wells.

Is CNOOC Making a Killing at Kenya's Expense?

¶10. (SBU) The Kenyan media reported in mid-February that injury has been added to insult because CNOOC is now shopping the Kenyan blocks internationally - in essence on-selling rights which the report alleges were acquired free of charge from the GOK. The report asks rhetorically, "Why Kenya agreed to sign such a lopsided deal dishing out privileges to CNOOC...remains the most intriguing aspect of the saga." There has been no comment yet from NOCK or the Ministry of Energy. That the Chinese are seeking to offload exploration acreage suggests they may be rethinking their position in Kenya - and/or that their timing is off. The recent failure of Australia's Woodside Energy to find oil in one of Kenya's most promising offshore blocks (ref A) has raised doubts about the existence anywhere in Kenya of oil or gas, and has probably devalued the blocks held by CNOOC and others.

Comment

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¶11. (SBU) That Chinese firms are not interested in investing in Kenya is in large part explained by the same reason FDI is depressed generally in Kenya: The investment climate is still poor thanks to the high costs and risks associated with lousy infrastructure, insecurity, excessive red tape, and corruption. On top of this, Chinese firms can usually out-compete other imports and local products by simply exporting from their low-cost factories in China. Thus the explosion in Chinese exports to Kenya (ref B). In short, it makes no business sense for Chinese entrepreneurs to make major investments in Kenya, no matter how much the Chinese and Kenyan governments would like them to do so.

¶12. (SBU) Oil, of course, is another story. Investment there is very much a strategic issue, driven by governments, and quite separate from conventional business wisdom. It would appear at this juncture that in its desire to please its new friend, Kenya's political leadership gave the Chinese a sweetheart deal in terms of oil exploration rights. The Chinese were more than happy to accept. Perhaps this was seen as a wise move in the context of the other benefits being extended to Kenya by the PRC. The deal appears not to be in Kenya's best interest in terms of achieving an oil or gas discovery sooner rather than later. And it has a distinctly bad odor, thus further damaging Kenya's already-poor image as a good destination for foreign investment.
Ranneberger